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SUBJECT: NORTH KOREA ECONOMIC BRIEFING - OCTOBER 2009

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Domestic Economy

12. (SBU) ROK Scholar: DPRK Economy Dysfunctional, Not in Crisis: According to Dr. Lee Suk, Research Fellow from the Korea Development Institute (KDI), the DPRK economy is dysfunctional, but is operating sufficiently to sustain the regime. In a conversation with Econoff, Dr. Lee assessed that the DPRK has been hurt by worsening relations with South Korea and outside pressure from the international community. The current market activities will not significantly help the DPRK economic system develop because the activity consists only of trading, rather than production. According to Lee, the DPRK leadership is determined to pursue a labor campaign to revive the economy by 2012. Although the campaign could improve short-term productivity, it will ultimately fail due to a lack of resources. This failure may pressure the DPRK to restore relations with South Korea and other countries.

13. (SBU) DPRK Restores Science and Technology Commission: North Korea's Central News Agency (KCNA) reported September 19 that North Korea has revived its State Science and Technology Commission (STC), which would oversee science and technology affairs. STC was

established in 1962 to support government-led efforts to grow the defense industry. It merged into the National Defense Academy of Science in 1998. The restoration of the STC could be part of the North Korean authorities' recent emphasis on the role of science and technology in transforming the DPRK into an economic power.

¶4. (SBU) DPRK Establishes Ship Control Center: According to KCNA on September 29, North Korea has recently established a control center to carry out the International Maritime Organization (IMO) system for identifying and tracking ships. The DPRK said the control center would ensure maritime safety and prevent sea pollution. Since 2006, the international Long Range Identification and Tracking (LRIT) system has required ships sailing in international waters to report their positions to control centers at least four times a day so they can be protected from terrorism or piracy. A ROKG official noted that North Korea has yet to test the system and has not transmitted any information on its flag vessels to other countries.

¶5. (SBU) DPRK Untouched by H1N1: There are no cases of H1N1 in the DPRK, according to an October 14 report in the Chosun Sinbo, a pro-North Korea newspaper in Japan. The article cited an official of the North Korea Emergency Anti-epidemic Commission who credited tightened quarantine inspections at all immigration points of entry and intensified local medical check-ups for the DPRK's success in avoiding an outbreak.

Foreign Trade and Investment

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¶6. (SBU) DPRK Seeks to Expand Trade: North Korea hopes to expand trade with friendly nations, Kim Mun-jong, Director of the North Korean International Exhibition Corporation, said on September 21, at the semiannual Pyongyang International Trade Fair. The Fair included companies from China, the Netherlands, Germany, Sweden, United Kingdom, Australia, Austria, Italy, Vietnam, France, Poland and Taiwan. In a single initiative, North Korea has scrapped extra land use fees and introduced selective import rules that could help foreign-owned companies maintain market share. A Chinese local daily, Jilin Newspaper, reported the DPRK also introduced state measures to ensure investor profits by banning imports of goods that are already produced in adequate quantities within the DPRK. Yoon Young-sok, Deputy Director General of the Foreign Direct Investment Bureau of the Trade Ministry, told Jilin the North Korean authorities plan to offer 60 percent corporate tax cuts for foreign investors who are invested in high-tech industries. (Note: The current corporate tax is 25 percent. For high-tech sector investors will be offered to pay 10 percent which is 60 percent tax reduced.) The income tax cut can be extended by two additional years with a 50 percent tax rate. Dr. Hong Ik-pyo, researcher at the (South) Korea Institute for International Economic Policy told Chosun Ilbo that the DPRK's FDI incentives are similar to those of South Korea and reflects the North's attempt to adapt to a market economy.

¶7. (SBU) DPRK-Russia Trade: Exports Up and Imports Down: According to the Korea Trade and Investment Promotion Agency (KOTRA), North Korean exports to Russia for the period January - June 2009 jumped 170 percent from the same period in 2008. Major items of the USD 16.8 million total included organic chemicals, steel and electrical machinery. Imports from Russia in the first half of 2009, however, declined to USD 18.1 million, down 65 percent from the previous year's total. Imports included diesel and petroleum oils, fertilizer, wood, paper and paperboard, and vehicles. North Korea's imports of vehicles between 1,500cc and 3,000cc in engine size jumped to more than double from the same period of 2008 and amounted to USD 2.5 million. Fertilizer imports spiked 839 percent to USD 1.1 million in the first half of 2009.

¶8. (SBU) DPRK-Pakistan Trade Continues to Drop: Pakistan's two-way trade with the DPRK dropped five percent to USD 11.7 million from July 2008 through March 2009, KOTRA reported on October 14. Pakistan analysts believe the trade deficit with the DPRK for the past three fiscal years has narrowed because of the recession in

Pakistan, continued devaluation of the rupee, and the Pakistan government's import control policy. Pakistan's imports of steel products from July 2008 through March 2009 rose 61 percent compared to a year earlier (to USD 6.4 million).

¶9. (SBU) DPRK Exports Magnesia to Switzerland: Quintermina AG, a Swiss mining developer, has signed an annual contract to import magnesia from the DPRK. The company will buy 100,000 metric tons of Fused Magnesium (MgO) and 40,000 ~ 50,000 metric tons per year of Dead Burned Magnesia (DBM) a year from North Korea's Chosun Magnesia Clinker Industry Group and the Seungri Magnesium Oxide Factory. It will then sell the magnesia to the United Kingdom, Germany and Eastern Europe, according to a September 25 VOA report.

¶10. (SBU) DPRK-China Agree on Public Health Cooperation: North Korea and China on September 14 signed an agreement of public health and medical science cooperation in Beijing, reported KCNA. Choi Chang-sik, North Korea's Public Health Minister, and the Chinese Vice Minister of Public Health were present at the signing ceremony. The agreement for public health and medical science cooperation will be implemented from 2009 to 2011.

¶11. (SBU) China to Refurbish and Expand DPRK Port: A China-based environmental equipment manufacturer, Chuangli Group, has recently acquired exclusive rights to refurbish, expand, and operate Rajin port No.1 wharf, according to Yonhap News Agency. The October 7 report said the remodeled port would be able to handle one million tons of cargo. In return, the company has agreed to build a 93 kilometer road linking Hunchun, Northeastern province of China and Rajin port. Meanwhile, Russian Railway Corporation had acquired the exclusive right to operate the third and fourth wharves at Rajin port in 2008. The company had agreed to modernize the railway linking Khasan, Russia and Rajin port.

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¶12. (SBU) EU Seeks Business Opportunity in the DPRK: A European Union business delegation led by a Dutch consulting firm, GPI Consultancy, visited North Korea September 22-26. The delegation visited Chosun Computer Center, Kimchaek University of Technology; Dakor, a DPRK-based data processing firm; and Nosotek, the first European-invested software development and research company in the DPRK. GPI Consultancy said the delegation was interested in Business Process Outsourcing (BPO) and IT-related activities such as data center operations, testing and quality assurance. It said that some Dutch computer game developers have recently acknowledged North Korea's potential IT skills by signing a BPO contract with a North Korean IT firm.

Inter-Korean Economic Cooperation

¶13. (SBU) Inter-Korean Trade Fell 16 Percent in August 2009: Continuing a twelve-month downward trend, inter-Korean trade in August fell to USD 136.6 million, down 16 percent from August 2008. Commercial transactions between the two Koreas shrunk five percent to USD 135.6 million, while non-commercial transactions declined 95 percent to a mere of USD 1 million. ROK exports to the DPRK dropped 36 percent to USD 53.8 million, while the imports in August rose by five percent to USD 82.8 million. Major exports for South Korea included raw materials for textiles, electronic equipment, and machinery. South Korea imported garments made in the KIC and commissioned projects from elsewhere in the DPRK.

Foreign Aid

¶14. (SBU) DPRK Grain Output Forecasts Vary: North Korea would require at least 1.8 million metric tons of food aid in the coming year, Food and Agricultural Office analyst Kisan Gunjal told Radio Free Asia (RFA) on September 23. Gunjal said North Korea's total rice output would be 2.4 - 2.6 million metric tons (mt.) this fall, similar to or lower than that of last year. The FAO also said that this year's corn output in the DPRK would be around 1.3 - 2.0

million mt. The FAO warned the DPRK may face a serious food shortage which requires as much as 1.8 million mt of food from the international community in the coming market year (November 2009 - October 2010). NOTE: FAO is consistently lower than other forecasters in its DPRK grain harvest predictions. END NOTE.

¶15. (SBU) Expressing a different view, Dr. Kwon Tae-jin, Senior Research Fellow of the Korea Rural Economics Institute, told us that grain output in the DPRK in the coming market year would rise around five percent to a total of 4.3 million mt. despite significantly reduced food aid from the ROKG and the United States in 2008. Kwon attributes the increase to the lack of flooding and favorable weather conditions over the summer. He also said that potato production in 2009 is expected to be good thanks to the ROK NGOs' contribution of potato seeds. He forecast that fertilizer production in the DPRK is expected to increase in 2010 because the DPRK has recently refurbished major fertilizer factories such as Heungnam Fertilizer Complex. Kwon said the DPRK would not face a serious food shortage in 2010.

¶16. (SBU) Noted corn biologist, Dr. Kim Soon-kwon, told us that based on his recent field observations in Kaesong and near Pyongyang, the corn and rice harvests could be off by 40 percent or more this year. Kim explained that weather conditions and a lack of quality fertilizer were the likely causes. He observed ears of corn that appeared to be a fraction of the size they should be so close to the harvest, and heads of rice that looked similarly stunted. He was in Pyongyang in September, and Kaesong in early October. Kim has routinely traveled to the DPRK over the past twelve years in support of agricultural development projects that his NGO, the International Corn Foundation is supporting. He told reporters in September that this year's corn crop was the worst he had seen in the DPRK since 1998.

¶17. (SBU) UNDP Resumes DPRK Operations: The UNDP Pyongyang office has resumed operations in the DPRK, KCNA reports. The office closed in 2006 due to the alleged misuse of funds.

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¶18. (SBU) WHO to Send H1N1 Vaccine to DPRK: The World Health Organization (WHO) will send H1N1 vaccines to the DPRK, according to an October 5 RFA report. The vaccines, which have been donated by the United States and eight other countries, are to be shipped to the DPRK after November. Exact quantities have not yet been determined.

STEPHENS